Pearl Meyer

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Four Facts Shaping Your Committee Agenda This Fall—And How to Address Them

Directors are facing more responsibilities than ever, and compensation committees are managing a continually growing list of relevant and urgent concerns. Visionary boards are increasingly thinking about executive compensation and leadership and talent management in a more cohesive way. It's in this context that directors are heads-down on the fundamentals while scanning the horizon for emerging issues, especially as they enter the busy fall planning season.

As a result of ongoing conversations with clients, colleagues, partners, and our director networks, we are highlighting four circumstances that will influence these fall agendas—whether an organization is public, private, or not-for-profit—and how each can be addressed in these critical upcoming meetings.

1. **Your compensation committee has more to accomplish than ever.** Consider the annual calendar as a framework for incorporating more leadership issues, and thoughtfully determining which "traditional" responsibilities can be managed more efficiently.
2. **The use of non-financial metrics has evolved.** It's time to reframe the focus on "ESG-related" metrics and simply determine which non-financial goals and objectives are critical to long-term value creation for your organization.
3. **New regulations are here and they run the gamut.** Taking the needed time to assess and incorporate a host of new and varied rules may also be a good opportunity to reassess your overall compensation philosophy—and potentially redefine it in a common-sense way.
4. **Work has changed.** We talked about this pre-pandemic and it's truer than ever. While the focus is often on the broad workforce, it's time to have a discussion about how the new work model influences board dynamics, leadership styles, and a senior management team's effectiveness.

We Have to Get More Done: Rethinking the Compensation Committee Calendar

Traditionally, the compensation committee's calendar focused predominantly on executive compensation matters in alignment with the committee's charter. Over the last eight to ten years, the compensation committee has become increasingly involved in issues of human capital management, including executive leadership development; CEO and other executive succession; robust talent pipelines and the risk of not having them; diversity, equity, and inclusion; pay equity and transparency; employee engagement and culture; and more.

As we have highlighted numerous times over the years, based on concrete data, the name of the committee is changing to reflect its broader remit, and charters are being amended to add these new responsibilities. But, as committees reshape their annual calendars to include broader human capital topics, one potential pitfall is to relegate those new items to one meeting per year.

The committee's broader responsibilities can—and should be—incorporated into each meeting's agenda. As is the approach with executive compensation, there should be a cadence that starts with beginning-of-the-year planning and builds to year-end decisions. An excellent starting point is taking the time to outline exactly what will happen when.

Starting with the current annual committee calendar that is likely compensation-centric, first consider adding a human capital update to each meeting. Typically, this update is led by the CHRO and serves to inform the committee on important and near-term human capital topics such as talent recruitment and turnover, progress on diversity and engagement efforts, and return-to-office initiatives.

Next, begin to layer in leadership development and succession planning into the quarterly committee planning process. Two examples: In Q1, the committee normally evaluates performance for the prior year and approves program payouts. This is an excellent time to also evaluate the performance of the management team in its leadership capacity. In Q2, when the committee may be at work on more process-oriented responsibilities, such as CD&A development and charter review, it may be a natural time to discuss the organization's leadership framework, outlining areas of opportunity and the actions that the committee suggests for improvement.

Recognizing that with additional agenda items comes the need for greater efficiency at meetings, it's likely most boards will need to outline an evolved process. This can include the wider use of pre-reads followed with in-person conversations, versus using valuable meeting time to review material before it is then discussed. Some boards are moving to consent agendas as another solution. Whatever path your compensation committee takes, the key is codifying this correlating set of responsibilities.

We've Turned a Corner on ESG

We have all experienced the call for including "ESG-related" metrics within executive-level incentive compensation plans. And with a broad view of what constitutes an ESG-related metric, it can now be said that a majority of S&P 500 companies include at least one in their executive-level incentive plans. However, recent investor sentiment has cooled on the acronym, and Supreme Court decisions on affirmative action have created uncertainty for boards that either have or are considering "social" metrics related to diversity, equity, and inclusion (DE&I).

We believe it's time to drop the headline-driving adjectives and simply focus on the non-financial goals and objectives that are critical to long-term value creation for your organization.

The use of non-financial metrics is not new. For years, many companies have been using metrics such as safety, customer satisfaction, and employee engagement. Companies that have an oversized potential impact on the environment have been using metrics related to their environmental stewardship. In these cases, the use of these metrics flows directly from their importance to the long-term success and sustainability of the business. Similarly, as more companies have identified a potential link between having a diverse and inclusive organization and long-term value creation, more companies have adopted metrics related to

DE&I. However, what has been a trend and what can be problematic is companies feeling pressure to check the box by having an ESG-related metric.

In general, most companies should be identifying, measuring, and tracking performance on a variety of non-financial metrics that are critical to long-term value creation. These are often leading indicators of performance and are therefore complementary to the traditional financial performance metrics, which are lagging indicators of performance. The question for many companies is whether incentive plans should focus on both performance drivers (non-financial) and performance outcomes (financial), or only clear, tangible performance outcomes. Companies will come to different conclusions on this question, but when non-financial metrics are included, boards and compensation committees need to carefully consider which to include and how performance will be measured. This decision, as with the many others that make up an executive compensation plan, needs to be based on what will best align pay and performance for your company.

We Face Multiple New Regulations: What, So What, and Now What?

After several years of relative quiet, the past year brought several new and proposed regulations, including:

- New pay vs. performance proxy disclosure;
- Tightened 10b5-1 trading plan requirements;
- Mandatory clawbacks for financial restatements;
- Pay transparency laws in more states and municipalities; and
- Proposed limits on the use of non-compete agreements and similar arrangements.

Law firms and consultancies have issued plenty of whitepapers on the details of the new regulations, as well as the ins and outs of compliance— the "what." At a baseline, many companies have adopted a "so what" shrug and relegated the issues to compliance exercises.

However, taken together, the underlying concepts of these rules—pay and performance, financial and ethical standards, transparency and fairness—clearly trend to the philosophical. The "now what" question for committees is whether and how these regulatory trends should influence internal decision-making and the governance of compensation programs. How do the leaders steering a company bring value for shareholders in a way that does not create risk, either legally or reputationally?

- **Pay versus performance (PvP): what can we learn?** The first year of PvP disclosure was marked with much grumbling over both the rules themselves and the accelerated implementation schedule. But now that the initial implementation is behind us, what can we learn from the new disclosure and how can the additional data improve our understanding of the relationship between pay and performance?
- **Clawbacks and 10b5-1 trading plans: an opportunity to safeguard integrity and reputation?** On the surface, both of these regulations are cut-and-dried. The new clawback rules mandate recoupment of compensation tied to financial restatements. The changes to 10b5-1 plans close perceived "loopholes" to bring programs more in line with the intent of the law. But fundamentally, both of these rules speak to safeguarding the financial integrity and reputation of the organization. So, as part of adopting the new rules, boards should ask if internal governance standards meet the organization's ethical expectations versus simply meeting the bare minimum of

compliance requirements.

- **Pay transparency and non-competes: a chance to improve retention?** The raft of local pay transparency rules and the proposed curtailment of non-compete agreements both have potential implications on how companies recruit and retain talent. Today roughly 25% of US employees work in a jurisdiction that has a pay transparency law and that number will increase over the coming months and years. However, beyond state and local mandates, potential and current employees increasingly expect a greater degree of transparency regarding their pay—both how it is determined and how it compares to their peers and the market in general. While the proposed non-compete ban is unlikely to be enacted in its current form, it portends a future where non-competes and similar provisions may become more difficult to implement and enforce. If companies lose the non-compete "stick" as a retention tool, they may need to focus even more on creating retention "carrots."

We Work Differently. How Can We Lead Better?

The best managers have seen a clear need to modify their leadership style and learn new skills in order to be highly effective in our current working environment. However, this evolution is not the norm. In a recent Pearl Meyer survey, just 24% of respondents say their organization has provided additional management training for executives, despite the workforce and workplace changes brought on by the pandemic.

Boards have an opportunity to help management teams address and avoid the growing specter of workforce concerns and enterprise risk by encouraging new approaches to leadership in a hybrid world, such as building connection and relationships across the organization in order to strengthen the culture and retain the best performers.

Because the survey also indicated 71% of the respondents have no specific requirements about how the day is structured when they meet in-office, there is also an opportunity to open productive conversations with management about how they are re-thinking work location policies and structuring time when teams are together. The right conversations will depend on board and management dynamics, but the fact remains we have experienced a major shift in how and where work happens, and it is a significant factor in the viability and growth of an organization.

While there are positive outcomes associated with remote work (greater flexibility and work/life balance, work autonomy, and more intentional collaboration), there are downsides to mitigate: disengagement of the workforce, leaders less skilled in remote management, fewer opportunities for spontaneous brainstorming that can lead to innovation, and less focus on the development of future leaders. These are harmful outcomes that can have long-range impact. It is worth taking the time as a board to have the conversation with management.

To kick off such a discussion, here are some examples reported by our survey respondents as focused actions to effectively lead and drive positive work cultures in hybrid conditions:

- More in-person all-employee meetings, town halls, or quarterly get-togethers, ranging in time from monthly to twice a year;
- More intentional, scheduled in-office event weeks/days—these time blocks include organized work and social events that draw employees in and are seen as essential to

staying connected; and

- Leaders increasing remote connection time with formal and informal touch points with employees, both one-on-one and in team settings to keep relationships going and build connection.

Finally, the last few years have highlighted an urgent need for companies to strategically plan for retention, development, and succession. Under hybrid ways of working, boards and management teams will need to place a special focus on ensuring that high-potential talent is being intentionally developed and being provided with the right experiences, both remote and in-person, in order to learn and grow.

Conclusion

Executive compensation plans alone are complex, effective catalysts for enacting a business strategy and achieving value, and compensation committees have a real need to evaluate, measure, and refine. There is no shortage of strategic conversations and decisions that take place around executive pay, particularly in the heavy fall planning season.

There is also no question that the responsibility of this committee has become complex. Evaluating risks, opportunities, and the ongoing growth of the teams leading the organization clearly has some influence on compensation plans. We see directors beginning to have congruent discussions about leadership and rewards (monetary and otherwise) in ways that help their organizations better weather uncertainty and quick shifts. But don't wait for a slower quarter. Timing matters and it may have the greatest impact to add these and similar topics to your agenda now, just as you're making key compensation decisions for the coming year.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.